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Intelligence Memorandum

Soviet Hard Currency Payments Position

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Soviet Hard Currency Payments Position

The Soviet hard currency deficit reached an all-time high of US $1.4 billion in 1972 and may rise to $2 billion in 1973. To cover these deficits the USSR has had to borrow heavily and to sell large amounts of gold. Although deficits of this magnitude are temporary, the Soviets face a growing balance-of-payments problem in the long term as a result of sluggish exports and rapidly rising debt service payments. To attack the long-range problem, Moscow has been seeking joint projects with Western countries to expand export production.

The major cause of the massive 1972-73 deficits is the large increase in imports of agricultural products in response to last year's poor harvest and the growing Soviet demand for quality foods. In 1972 the deficit was financed mainly with credits of about $1 billion which included, for the first time, substantial short-term and medium-term Eurodollar loans. Sales of 150 metric tons of gold, the first large sales in six years, brought in another $300 million. In 1973, no more than one-half of the $2 billion deficit will probably be financed through credits, including $400 million in US Commodity Credit Corporation (CCC) loans. The remainder will be covered by gold sales, which totaled 150 tons in the first half of the year and are likely to be at least this large, and possibly as high as 250 tons, during the second half. Increased reliance on gold sales and reduced dependence on Eurodollar borrowing were induced by both the higher price of gold and the higher cost of borrowing.

Although Soviet imports of agricultural products will decline from the record 1972-73 level, the pressure on the USSR's hard currency balance of payments may continue. For years, Soviet exports have been growing much more slowly than imports of industrial goods, with a substantial part of the imports of machinery and equipment being financed by medium-term and long-term credits. Service payments on the rapidly growing hard currency debt have been increasing by leaps and bounds and will be equal to about 27% of export earnings this year, compared with only 11% as recently as 1967. The problem is that very little of increased production which resulted from past Western credits can be exported for hard currency. Unless export growth accelerates greatly, the USSR may soon feel constrained to reduce its foreign borrowing; consequently the growth of import capacity will slow down.

Note: Comments and queries regarding this memorandum are welcomed. They may be directed to [redacted] 25X1

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Moscow is seeking a long-term solution to this problem by acquiring Western technical and financial assistance to develop new exports of fuels and raw materials. The credits involved in these projects not only are self-liquidating but also will result in large net hard currency earnings for the USSR. But this will take time. Although existing export-oriented projects are already yielding substantial export earnings, these will not exceed repayments until the late 1970s. The much larger bilateral projects currently being considered, such as the two natural gas deals with the United States, would not help the balance of payments until the mid-1980s. In the interim the USSR will probably sell gold, perhaps about 300 tons per year. Even so, Moscow may also have to curtail the growth of imports.

US-Soviet trade has increased much faster than total Soviet trade with the West in the past two years, largely because of US exports of agricultural products for delivery in 1972 and 1973. Exports of US machinery and equipment are also rising. About $800 million in US credits have been made available to the USSR since June 1972 to help finance these exports. Continuing purchases of US equipment and grain by the Soviets should ensure a major US role in the USSR's economic ties with the West. US participation in major Soviet projects to develop fuels and raw materials will be a major factor in increasing US-Soviet trade.

DISCUSSION

Introduction

1. The Soviet merchandise trade balance with hard currency countries has been chronically in deficit, averaging about $250 million annually from 1960 through 1971.[1] After relying mainly on gold sales to finance these deficits in the early 1960s, the USSR stopped selling large quantities of gold after 1965 and rebuilt its reserves. Deficits were covered with medium-term and long-term credits, mainly government-backed, and the Soviet medium-term and long-term debt to the West grew steadily to about $2 billion by the end of 1971.

2. Two developments have dramatically changed the dimensions of the USSR's hard currency problem since 1971. One mediocre harvest in 1971 followed by a poor harvest in 1972 forced the USSR to purchase large quantities of grain and sugar to sustain Brezhnev's program for upgrading the Soviet diet. At the same time, a disappointing performance in the economy generally and in industry in particular convinced the leadership that substantial Western help would be needed to upgrade the level of Soviet technology. This memorandum discusses Soviet currency payments problems in 1972 and 1973 and assesses both the short-term and long-term outlook for the balance of payments.

Abrupt Rise in Hard Currency Trade Deficit, 1972-73

3. In 1972 the trade deficit rose abruptly to a record $1.4 billion (see Table 1). Large imports of grain and sugar from hard currency countries accounted for much of the deficit, but imports of machinery and equipment and steel pipe also rose. Oil exports -- the USSR's main hard currency earner -- declined slightly, while some other traditional exports such as grain, sugar, coal, ferrous metals, and ores declined or did not increase.

4. The USSR's hard currency deficit will worsen in 1973, largely because most of the grain bought in 1972 will be delivered this year. The USSR will probably import at least $1.5 billion of agricultural products (chiefly grain but also soybeans, sugar, and butter) and about $1.5 billion of machinery and equipment. Hard currency imports may total $5 billion. The expected increase in exports in 1973 will be small, and the hard

1. Throughout this memorandum, deficit refers to the merchandise trade deficit. Several elements of the current account cannot be estimated. Those that can (e.g., tourism and interest on loans) indicate that the balance on merchandise trade does not differ substantially from the balance on current account. For the estimates of the balance of payments in 1971 and 1972, see the Appendix.

Table 1

USSR: Hard Currency Trade Deficit

Million US $

	Exports	Imports	Balance
1960	768	1,018	-250
1961	900	1,061	-161
1962	951	1,184	-233
1963	1,012	1,287	-275
1964	1,073	1,556	-483
1965	1,374	1,560	-186
1966	1,517	1,755	-238
1967	1,711	1,616	95
1968	1,909	2,018	-109
1969	2,125	2,436	-311
1970	2,197	2,711	-514
1971	2,652	2,955	-303
1972	2,815	4,171	-1,356
1973[1]	3,000	5,000	-2,000

1. Estimated.

currency deficit may reach about $2 billion. More than half of the deficit will be with the United States, which will deliver $1 billion in grain and several hundred million dollars worth of machinery and equipment to the USSR.

5. The large increase in agricultural imports has changed the geographic distribution of Soviet hard currency trade. Table 2 shows this shift between 1971 and 1972; the 1973 pattern will be like the 1972 distribution. The United States and Canada were the chief beneficiaries, and the USSR's largest trade deficit was with the United States.

Soviet Management of the 1972-73 Deficit

6. So far the USSR has been able to handle the mounting hard currency deficits without much trouble. Western credits covered more than three-fourths of the 1972 hard currency deficit of $1.4 billion:

- Estimated net medium-term and long-term credits backed by Western governments amounted to almost $500 million -- mainly to pay for imports of machinery, equipment, and pipe.

Table 2

USSR: Trade with Selected Hard Currency Countries[1]

Million US $

	1971			1972		
	Exports	Imports	Balance	Exports	Imports	Balance
Total hard currency trade	2,652	2,955	-303	2,815	4,171	-1,356
Of which:						
United States	60	144	-84	92	558	-466
West Germany	292	484	-192	322	710	-388
Japan	419	396	23	462	525	-63
France	216	313	-97	235	424	-189
United Kingdom	452	222	230	449	226	223
Italy	259	291	-32	276	285	-9
Canada	14	151	-137	23	340	-317

1. Based on Soviet data: exports and imports f.o.b.

- About $100 million of CCC three-year credits were drawn to finance grain purchases from the United States.

- The USSR tapped the Eurocurrency market for several hundred million dollars in both medium-term and short-term credits to finance imports of machinery and grain.

As a result of its extensive borrowing in 1972, total outstanding debt on government-backed credits climbed to about $2.6 billion (see Table 3). To cover that part of the deficit not financed by credits, the USSR sold gold in substantial quantities for the first time since 1965. Sales in 1972 exceeded 150 tons and earned roughly $300 million.

7. In 1973 the USSR has taken advantage of high gold prices (and has avoided high interest rates) in financing its hard currency deficit. Soviet gold sales of 150 tons have already earned about $400 million and an additional 150-250 tons could bring in another $500 million to $800 million this year. Gold sales could thus provide as much as $1.2 billion of the $2 billion in hard currency the USSR needs to cover its 1973 trade deficit. Government-backed Western credits (net of repayments and including $400 million of CCC credits for grain) will provide another $700 million. As a last resort the USSR will pay the high interest rates now prevailing for non-guaranteed loans to finance the deficit not covered by gold sales and

Table 3

USSR: Drawings and Repayments on Medium-Term and Long-Term Credits Guaranteed by Western Governments

	Million US $				
	Estimated Drawings	Scheduled Repayments (Principal and Interest)	Net Credits	Outstanding Debt End of Year	Debt Service Ratio[1] (Percent)
1965	190	166	24	380	12
1966	275	170	105	505	11
1967	305	181	124	658	11
1968	510	255	255	951	13
1969	630	322	308	1,316	15
1970	700	379	321	1,717	17
1971	700	463	237	2,057	17
1972	1,030[2]	562	468	2,649	20
1973[3]	1,500[2]	801	699	3,508	27

1. Ratio of scheduled repayment of principal and interest on medium-term and long-term credits (in this table) to value of Soviet exports to hard currency countries (in Table 1).
2. Including drawings on three-year CCC credits.
3. Preliminary.

government-guaranteed credits. Thus the burden of the USSR's recent hard currency deficits has been lightened considerably by easy access to Western credits and by the windfall arising from the sharp increase in the price of gold. In addition, the dollar devaluations have permitted the substantial Soviet borrowing on the Eurodollar market in 1972 to be repaid by cheaper dollars.

Long-Term Payments Problems

8. If the 1973 harvest is as good as expected, Soviet outlays for grain and sugar and the hard currency trade deficit will be substantially smaller in 1974. The payments problems will not disappear, however, because medium-term and long-term debt continues to grow. For more than a decade, Soviet exports to hard currency countries have failed to keep pace with imports of industrial goods, and a substantial portion of imports of machinery and equipment from the West has been and continues to be financed by medium-term and long-term credits. Imports of machinery and equipment, which rose sharply in 1972 and 1973, will continue to

increase because of the new contracts signed in the last year. An even larger share of these imports is currently being financed by credit than was the case in earlier years.

9. Service payments on the growing Soviet debt to the West have been increasing rapidly. In 1967, debt service took about 11% of Soviet exports to hard currency countries and in 1973 will probably account for 27% of exports. In 1974 the debt service ratio apparently will be even higher. The growth of Soviet exports to hard currency countries during the balance of the decade is projected at 6%-7% annually. Exports to the West will continue to be made up largely of the traditional fuels, raw materials, and semimanufactures – oil, gas, timber, ores, metals; exports of these products will probably grow more slowly in the 1970s than in the past. Because of increasing internal demand and limitations on supply, oil exports -- the USSR's chief foreign exchange earner – will increase only moderately, largely because of higher prices rather than of greater volume. Despite Brezhnev's expressed hope that the USSR will export more processed and manufactured goods, notable successes in this area are not expected during the 1970s. If exports do not grow substantially faster, the USSR may decide to cut back its borrowing from the West to hold the ratio of debt service to exports within what it considers to be reasonable bounds. Since repayments on past credits will continue to rise for some time, there would then be a shift from a net inflow to a net outflow of funds on capital account.

10. Because Western machinery and equipment has such a high priority, the USSR will probably try to prevent a credit squeeze from interfering with imports. The USSR has the option of selling about 300 tons of gold annually during the 1970s without reducing reserves. Sales of this magnitude would go a long way toward covering expected hard currency deficits during this period. The USSR could sell even more gold and accept some reduction in its reserves. With gold production expected to surpass the 300-ton level in a year or two, this could be a viable option. Nevertheless, Moscow may have to curtail the growth of imports if gold sales prove to be insufficient to bridge the gap between exports and imports. By the beginning of the 1980s the USSR probably hopes that exports will be helped by the large-scale fuel and raw material projects now being discussed with Western firms.

Attempts to Generate Exports by Self-Liquidating Projects

11. In the past the USSR has used Western machinery mainly to upgrade production for domestic use. Now the USSR is trying to use some of the Western equipment and technology for export expansion. Specifically, it has endeavored to repay credits with the products of the installation

built with the credits and has sought contracts for exports of these products in excess of repayments. The credits involved in these projects thus will be self-liquidating and will result in net hard currency earnings for the USSR. Work is under way on about a half dozen such projects -- with the Japanese (timber projects and port development) and several West European countries (gas for pipe). The USSR will have drawn down about $1.1 billion in such credits by the end of 1973 and repaid almost $300 million. Of the estimated total debt outstanding of $3.5 billion at the end of 1973, some $800 million will be of the self-liquidating type. By the time these credits are amortized in 1984, the projects involved will earn the USSR roughly $700 million over and above repayments. An additional $1 billion in earnings will accrue to the Soviets by 1990, when product deliveries terminate. A schedule of estimated drawings and repayments on the self-liquidating credits concluded to date is shown in Table 4.

Table 4

USSR: Estimated Drawings and Repayments on Self-Liquidating Credits Concluded by August 1973

Million US $

		Repayments				
	Drawings	Principal	Interest	Total	Export Earnings	Net Earnings
Total	**1,511**	**1,511**	**405**	**1,916**	**2,599**	**683**
1969	60	8	....	8	24	16
1970	236	36	3	39	30	-9
1971	194	52	15	67	44	-23
1972	259	66	24	90	65	-25
1973	340	117	35	152	132	-20
1974	277	149	49	198	115	-83
1975	145	162	56	218	141	-77
1976	....	149	55	204	174	-30
1977	....	135	46	181	207	26
1978	....	130	38	168	229	61
1979	....	127	30	157	243	86
1980	....	121	23	144	243	99
1981	....	111	16	127	243	116
1982	....	76	9	85	243	158
1983	....	44	4	48	233	185
1984	....	28	2	30	233	203

Proposed Joint Projects

12. The USSR is currently negotiating several other cooperative projects similar to those already concluded. [redacted] 25X1 According to another Soviet contract, an Italian firm, Montedison, will export $200 million to $250 million worth of chemical equipment on credits in return for ammonia and other chemicals. A smaller deal concluded with a French company covers the export of equipment for a woodpulp plant and repayment in woodpulp.

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Outlook for US-Soviet Trade

16. The United States had the largest increase in trade with the USSR in 1972 among Western countries, more than tripling its trade turnover and becoming the fifth largest Soviet hard currency trading partner. The US trade surplus with the USSR -- $466 million -- was equal to one-third of the Soviet hard currency deficit. US trade with the USSR in 1973 should make the United States the largest trading partner of the USSR in the West, with grain deliveries valued at about $1 billion and machinery and equipment on the order of $300 million. The surplus will exceed $1 billion because imports will probably be no greater than $150 million.

17. The US-Soviet detente has opened up a large new area of credits for the USSR, and the USSR has made extensive use of them in the first year of large-scale trading with the United States. With $500 million[3] in CCC grain credits, Eximbank participation in machinery credits -- principally for contracts for the Kama truck plant -- and private, nonguaranteed bank credits, the USSR has already received US credits worth more than $800 million since June 1972.

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3. Including $100 million drawn in 1972 and $400 million in 1973.

18. The United States will continue to have a major share of Soviet hard currency trade and financing in the future. Soviet orders for plants and equipment from the West continue to increase, and the United States is receiving a large proportion of them – $600 million since the May 1972 summit. The large-scale proposals for exploiting fuel and raw material deposits that are being discussed with US firms would -- if adopted -- give the United States a rising surplus in its trade with the USSR for most of the 1970s. Finally, the requirements of the Brezhnev program will probably force the Soviets to buy grain consistently over the next several years, and the United States should receive a large share of these orders.

APPENDIX

USSR: Estimated Hard Currency Balance of Payments

Million US $

	1971		1972	
	Credit	Debit	Credit	Debit
Goods and services	....	271	....	1,375
Merchandise[1]	2,652	2,955	2,815	4,171
Transportation, net	50	....	....	....
Travel	96	21	120	25
Interest repayments on credits[2]	....	103	....	124
Dividends[3]	10	....	10	....
Transfer payments[4]	....	43	....	45
Capital and monetary gold	354	....	880	....
Medium-term and long-term Western credits	700	360	1,030	438
Compensation payments[5]	....	11	....	12
Monetary gold	25	....	300	....
Errors and omissions, net[6]	....	40	540	....

1. Derived from Soviet statistics; exports and imports are f.o.b.
2. Interest payments are those made on medium-term and long-term credits obtained from Western countries mainly to finance imports of machinery and equipment. Interest payments and receipts on short-term loans are not included.
3. Including profits of Soviet-owned banks and firms in the West.
4. Payments made in hard currency to the United Nations and UN-affiliated organizations.
5. Soviet payments on principal and interest in accordance with the US lend-lease "pipeline" agreement.
6. Including changes in hard currency holdings, short-term capital movements, and hard currency repayments from less developed countries for Soviet credits.